New rescue effort called key to resuming lending

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San Jose Mercury News
March 23, 2009

WASHINGTON — Financial markets roared ahead Monday as investors reacted with near-euphoria to the Obama administration's new trillion-dollar plan to stabilize banks by relieving them of their troubled assets and risky loans.

But even as markets exulted, conflicting interests among participants in the program — banks, investors and taxpayers — were emerging, leaving in doubt the fate of a program meant to revive bank lending and in turn reinvigorate the overall economy.

Some banks are resisting government pressure to sell assets at prices they believe to be too low. And despite the risk of an outcry from Congress, the Treasury this weekend made the program more attractive to private investors, according to industry and some government officials. Treasury officials said the last-minute changes were not intended to sweeten the deal.

In the short run, the rollout of the plan gave a much-needed boost to the administration and beleaguered Treasury Secretary Timothy Geithner, as officials on Wall Street and Washington in general spoke favorably of the plan. The Standard & Poor's 500 stock index rose 7.1 percent in the best day for the stock market in five months.

"The policymakers definitely have the right ideas in their head right now, but whether they can execute it I don't know," said Daniel Alpert, managing director of Westwood Capital, a boutique investment bank.

The new Public-Private Investment Program, which Geithner announced Monday, includes programs to buy up real-estate-related loans and securities backed by those loans. It will combine $75 billion to $100 billion in financial rescue funds already approved by Congress with investments from private investors, loan guarantees by the Federal Deposit Insurance Corp. and loans from the Federal Reserve to buy up to $1 trillion in real-estate-related assets.

Government officials said they hope that introducing new buyers will help set a floor for asset prices and stabilize the broader financial system by removing troubled assets from financial firms.

But the initiative leaves the Treasury's financial rescue fund nearly tapped out, and with a hostile environment in Congress, administration officials are worried that they might be unable to get more money. If the Treasury uses the full $100 billion, it would leave only $12 billion uncommitted from the $700 billion financial rescue package that Congress approved in early October, according to tabulations by the Committee for a Responsible Federal Budget.

Geithner's credibility with Congress was at a low ebb after the outcry last week over bonuses paid to executives of American International Group. Congressional leaders still say it would be difficult to pass a law giving the Treasury any further funds for financial rescues.

Yet without those funds, the Treasury was forced to stretch the dollars it already has, crafting a plan that is complex and probably more costly to taxpayers over the long term than if Congress provided help.

Geithner and his colleagues at the Treasury Department have been trying to design a program that achieves several objectives: giving private investors plenty of incentive to buy the distressed assets, getting banks to willingly sell these assets and protecting taxpayers from unreasonable risk.

Treasury officials made changes to the plan in recent days in a way that makes it more favorable to private investors, according to government and industry sources. For instance, on Saturday, the draft plan called for the Treasury to put in four times as much equity as private investors, which would give taxpayers a greater windfall if the banking system recovers and the investments become profitable. But Treasury officials surrendered some of those potential gains after listening to the concerns of hedge funds and private-equity funds on Sunday, industry officials said.

The Treasury increased private investors' share of potential profits from 20 percent to 50 percent. A senior official at the department said it was not because the Treasury wanted to make the deal better for the investors but because it wanted to send a consistent message that the government would take the same stake as the private sector across all rescue programs. A smaller Treasury stake also means less risk for taxpayers, the official said.

The response from major investors Monday was strongly supportive. Bill Gross, co-chief investment officer of Pimco, the nation's largest bond investor, said his firm is eager to participate and that the program is a "win-win-win" policy that "should be welcomed enthusiastically."

Some analysts and senior government officials fear that taxpayers may be giving up too much — including potential double-digit-percentage returns — to the investors.

"We are giving the private side a certain package that could well be much more than is necessary to get them, in which case the taxpayers are leaving a lot of money on the table," said Lucian Bebchuk, a Harvard Law School professor who was an early advocate of the government's approach.